

Section VIII: Conclusion -- Compliance with the National Affordable Housing Act

According to our estimates for the base-case economic scenario, as of the end of FY 2005 the MMI Fund had an economic value of \$21.621 billion and unamortized insurance-in-force of \$358.871 billion, resulting in a capital ratio of 6.02 percent. Furthermore, we project that by FY 2012 the capital ratio would increase to 6.62 percent. Therefore, we conclude that the Fund would continue to exceed the 2.00 percent minimum level required by NAHA.

The most significant finding in this year's Review is the weaker performance of loans with downpayment gift assistance from non-relative entities. Recent historical data indicate that these loans had been claimed three times faster than otherwise identical non-gift loans. Assuming the same performance difference exists throughout the remaining life of these loans, this effect by itself introduced a \$1.76 billion reduction in the economic value of the MMI Fund as of the end of FY 2005. Furthermore, if these loans experience stressed economic conditions in the future as suggested by the sensitivity analyses presented in Section V of this Review, the initial capital ratio of some future books of business could become negative. Given the significance of the impact of these loans, it is important for FHA to carefully review this particular program. This feature will continue to be a focal point of the Actuarial Review over the next few years.

The other important trend is that the total FHA originations of the FY 2005 book of business was 40 percent lower than was estimated in the FY 2004 Review, mostly driven by the continuous decline in FHA's market share during the last two years. The lower volume of new books of business leads to the slower increase in the economic value of the MMI Fund. However, the smaller volume also leads to the smaller future IIF of the Fund. As the impact on the reduction in the IIF is greater than that on the economic value, the smaller volume tends to cause the long-term capital ratio to rise. Because the impact on insurance in force is higher than that of the economic value, further decrease in new business volume tends to lead to rapid rising of the Fund's capital ratio.

Due to the high origination volumes and the high prepayment rates over the last couple years, the current MMI Fund insurance in force is heavily concentrated in the most recent books of business. Loans originated in FY 2003 through FY 2005 account for approximately 63 percent of the current unamortized insurance in force. The overall claim rate of the Fund is expected to steadily increase during the next few fiscal years as these newly originated loans enter their peak claim years, as captured by the econometric analyses in this review. However, the alternative scenario analyses performed in this study suggest that this concentration is not likely to reduce the capital ratio of the MMI Fund to below the NAHA-mandated 2 percent level in the foreseeable future.